IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No. 182 of 1993

For Approval and Signature:

THE HON'BLE MR.JUSTICE D.A.MEHTA
HON'BLE MS.JUSTICE H.N.DEVANI

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1	Whether Reporters of Local Papers may be allowed to see the judgment ?
2	To be referred to the Reporter or not ?
3	Whether their Lordships wish to see the fair copy of the judgment ?
4	Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 of any order made thereunder ?
5	Whether it is to be circulated to the civil judge ?

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COMMISSIONER OF INCOME TAX - Petitioner(s)

Versus

SCIENTIFIC CHEMICALS - Respondent(s)

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Appearance :

MR MANISH R BHATT for Petitioner No(s).: 1.

MR NR DIVETIA for Respondent No(s).: 1.

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CORAM :THE HON'BLE MR.JUSTICE D.A.MEHTA

HON'BLE MS.JUSTICE H.N.DEVANI

Date : 21/06/2005

ORAL JUDGMENT

(Per : THE HON'BLE MR.JUSTICE D.A.MEHTA)

1. The following question has been referred at the instance of revenue by the Income Tax Appellate Tribunal, Ahmedabad Bench “C” under Section 256(1) of the Income Tax Act, 1961 (the Act).

“Whether, the Appellate Tribunal is right in law and on facts in cancelling the penalty levied under Section 271(1)(a) of the Income Tax Act?”

1. The Assessment Year is 1982-83. The assessee, a registered partnership firm was required to file return of income on 30th June 1982, whereas the same was filed on 31st May 1983. The Income Tax Officer issued notice under Section 274 read with Section 271 of the Act requiring the respondent assessee to show cause why penalty should not be imposed for late submission of return. In the order levying the penalty, it is stated that “since there is no reply from the assessee, it is clear that there is no reason to offer by the assessee firm”. It is further stated that he was therefore “satisfied that the assessee has without any reasonable cause failed to file the return in time and thereby, committed default and was liable to penalty”. Accordingly, penalty of Rs.14,730/- was levied under Section 271(1)(a) of the Act.
2. The assessee carried the matter in appeal before the CIT (Appeals), who for the reasons stated in his order dated 18th October 1987, allowed the appeal partly. On behalf of assessee, two fold contentions were raised before the CIT (Appeals). Firstly, it was urged that the assessee had filed the extension application in form No.6 seeking extension upto 30th September 1982, but the Income Tax Officer had failed to deal with the said application for extension of time. Secondly, it was contended that the Income Tax Officer had not cared to consider the explanation tendered by the assessee despite the fact that the assessee had submitted explanation vide letter dated 1st January 1985, which was filed on 28th January 1985; and assessee had also given reasons for late filing of return under covering letter dated 26thMay 1983 along with the return of income. The CIT (Appeals) followed the decision of this High Court in the case of Commissioner of Income Tax, Gujarat-IV v. Gordhanbhai Jethabhai, [1983] 143 ITR 84, and held that the assessee had valid reason upto 30thSeptember 1982 considering the fact that extension application was not responded to by the Income Tax Officer. However, without dealing with the submission made on behalf of assessee regarding non-consideration of the explanation tendered, the CIT (Appeals) proceeded to consider the explanation of the assessee on merits and held that the explanation was not plausible in his opinion. He, therefore, confirmed the penalty for the period of default from 1stOctober 1982 till the date of filing of the return.
3. The assessee carried the matter in appeal before the Tribunal. The Tribunal, while upholding the findings of CIT (Appeals) on merits of the matter, cancelled the penalty by its order dated 12 thOctober 1990, holding that the plea of the assessee to the effect that the penalty order was bad in law as the same was passed without application of mind, merited acceptance. It is against this order that revenue has come up in reference.
4. Mrs.M.M.Bhatt, the learned Standing Counsel for the applicant revenue submitted that once both the appellate authorities, namely CIT (Appeals) and the Tribunal, had concurrently found

on facts that there was no reasonable cause, the Tribunal had committed an error in law in cancelling the penalty. It was submitted that the explanation tendered by the assessee had been considered on merits by the appellate authority and hence, no prejudice had resulted which would entitle the assessee to seek cancellation of the penalty. Referring to the opening portion of Section 271(1) of the Act, it was submitted that the satisfaction for levy of penalty could be that of the Income Tax Officer or the Appellate Assistant Commissioner or the Commissioner (Appeals), and hence, if explanation of the assessee had been considered by CIT (Appeals), it could not be stated that the assessee was not granted proper opportunity or was not heard. It was further submitted that the order of the Income Tax Officer levying the penalty had merged with the order of the appellate authority and hence, it was not possible for the Tribunal to strike down the order of the Income Tax Officer as the same did not exist independently. She, therefore, urged that the Tribunal's order be reversed and the order of Commissioner (Appeals) be restored, answering the reference in favour of revenue.

5. Mr.S.N.Divetia, the learned counsel appearing on behalf of respondent assessee submitted that the Tribunal's order was required to be upheld in light of the principles laid down in the following decisions :

(a) Commissioner of Income Tax v. Textile And General Engineer Co., [2003] 259 ITR 735 (Gujarat)

(b) Commissioner of Income Tax v. G.R.Rajendran, [2003] 259 ITR 109 (Madras).

©Tin Box Company v. Commissioner of Income Tax, [2001] 249 ITR 216 (SC).

1. Responding to the submissions on behalf of appellant, he submitted that when the section empowered either the assessing authority or the appellate authority to record satisfaction, it had to be read in context of the powers of enhancement available to the appellate authority. That once it was found that the explanation of the assessee had not been considered by the assessing authority while levying the penalty whether the said explanation was considered by the appellate authority or not, was besides the point, and the first order levying the penalty was required to be quashed and set aside.
2. As can be seen from the impugned order of Tribunal, the Tribunal has recorded that the principle of merger of the order of subordinate authority with that of superior authority would normally prevail when the order of subordinate authority comes up for judicial scrutiny before the superior authority, but the said principle could not be stretched and applied to the extent that in penalty proceedings, right of an assessee to tender explanation and have it considered is shut out by totally ignoring or not considering the same by the subordinate authority, namely the Income Tax Officer. Elaborating on this, Tribunal has held that the explanation offered by an assessee may or may not satisfy the Income Tax Officer; in case, the Income Tax Officer is satisfied with the explanation tendered, he would drop the penalty proceedings, and then there would be no occasion to go in appeal. The Tribunal has, therefore, held that such a right of an assessee cannot be taken away by exercise of any appellate jurisdiction.

   8.1 The Tribunal has further approached the issue from a slightly different angle inasmuch as it has held that, in such case, where the assessee's explanation is not considered by the Income

Tax Officer and is taken into consideration by the appellate authority for the first time, it would mean that the appellate authority has proceeded on the footing that the explanation has been rejected by the Income Tax Officer, whereas in fact the same has not been considered at all. It has further been held that such substitution of satisfaction cannot be permitted considering the fact that, under the statute, the Income Tax Officer who has initiated the proceedings has to exercise discretion, whether to levy penalty or not.

8.2 It has further been held by the Tribunal that, applying the analogy of the ratio of decision of this Court in case of Commissioner of Income Tax v. Gordhanbhai Jethabhai (supra), if non-consideration of extension application can lead to a legal inference that time sought for was granted, non-consideration of the explanation of an assessee would lead to a legal inference that the explanation was not rejected, and would exonerate the assessee from penal proceedings.

3. The learned counsel for the applicant revenue has not been able to point out any legal infirmity in the aforesaid line of reasoning adopted by the Tribunal. Apart from that, this Court also does not find that the order of the Tribunal suffers from any legal infirmity as such.
4. As held by the Apex Court in the case of Tin Box Company (supra) that once the Tribunal found that the Income Tax Officer had not given to the assessee proper opportunity of being heard, whether the assessee could have placed the evidence before the appellate authority or before the Tribunal, was really of no consequence for it was the assessment order that counted: that order had to be made after the assessee had been given a reasonable opportunity of being heard. Principles of natural justice take within its sweep not only the right of reasonable opportunity, but also the right of being heard. The right of being heard would encompass the factum of the explanation tendered being considered before the assessing authority decides to pass an order. Section 271(1)(a) of the Act grants discretion to the Income Tax Officer to levy or not to levy penalty. This is clear from the phrase “He may direct that such person shall pay by way of penalty”, namely, the Income Tax Officer may direct or may not direct levy of penalty considering the fact that he is required to be satisfied whether any person has committed the stipulated default “without reasonable cause”. Such a satisfaction can be recorded only if proper and adequate opportunity is accorded to the assessee. Therefore, before the authority can exercise discretion vested in it, it is imperative for the authority to grant reasonable opportunity and this would take within its fold right of being heard and the explanation tendered as to existence of reasonable cause being taken into consideration before the order to levy penalty is made. The legal position in this regard is well settled and bears no repetition. The authority vested with discretion by a statutory provision is under a mandate to exercise such discretion in a judicial manner and not arbitrarily. When the explanation tendered by the assessee is ignored or omitted from the zone of consideration before the order is made,it would definitely violate the principles of natural justice. The order would be vitiated by exercise of arbitrariness in decision-making process and the discretion cannot be stated to have been exercised judicially.
5. There is one more aspect of the matter. When an authority is vested with discretionary powers and omits to take into consideration the explanation tendered, which has admittedly been filed in response to the show cause notice, the order would suffer from the vice of non-application of mind when the order records that no explanation is tendered. In the present case, admittedly, it

has been found by the Tribunal that though the explanation was tendered, the Income Tax Officer proceeded on the footing that no explanation was tendered and thus, it is established that the order stands vitiated for non-application of mind. If a statute invests a public officer with authority to do an act in a specified set of circumstances, it is imperative upon him to exercise the authority in a manner appropriate to the facts and circumstances of the case when a party interested and having a right takes appropriate steps in that regard and circumstances for exercise of authority with the discretion are shown to exist. The exercise of discretion has to be in a judicial manner, namely fairly and reasonably.

6. Applying the aforesaid principles to the facts of the case, it is apparent that assessee had tendered an explanation before the Income Tax Officer in response to the show cause notice issued by him, such explanation has been ignored by the Income Tax Officer in entirety by stating that no explanation has been tendered and in the circumstances, the order levying penalty suffers from violation of principles of natural justice and vice of non-application of mind and cannot be allowed to stand. The Tribunal was, therefore, justified in holding that the order levying the penalty was bad in law and could not be sustained.
7. The question referred to the Court is, therefore, answered in the affirmative i.e in favour of the assessee and against the revenue. Reference stands disposed of accordingly. There shall be no order as to costs.

[D.A.MEHTA, J.]

[HARSHA DEVANI, J.]

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